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TAGS: [ECON](#) [EFIN](#) [PREL](#) [EAID](#) [EG](#)
SUBJECT: EGYPT: FINANCIAL SECTOR CASH TRANSFER IMPLEMENTATION
RESUMED

Sensitive but Unclassified. Please protect accordingly.

REF: Cairo 1932

Summary

1. (U) After several months of waiting for the Central Bank of Egypt (CBE) to provide draft terms of reference (TORs) for international audit firms' work in the state-owned banks, we now have bilaterally-agreed TORs and the auditors can get down to business. This ends the worrisome delay in the process leading to the next disbursement of funds under the Financial Sector Reform cash transfer.

The Problem

2. (U) The next disbursement of funds under the Financial Sector MOU cash transfer program requires audit firms working to international standards to provide data from the state-owned banks on progress towards: (i) reducing non-performing loans (NPLs), (ii) cash recovery of the NPLs, and (iii) growth in private banks' share in total bank lending. "Pro rata" disbursements over the coming three years of \$475 million depend on this progress. Per reftel, Embassy was concerned about delays in starting the audits.

Governor reviews the CBE's accomplishments

3. (U) On July 8, the Ambassador, Treasury attache, econoff, and USAID met with Governor El Okdah to inquire about the TORs. The Governor started with a very positive review of the financial-sector reform program, saying that he had accomplished 80 percent of the goals that he had set for himself. He said that by 2008, all Egyptian banks would finally be solvent thanks to energetic measures on NPLs, including substantial cash recoveries from an "amnesty" program for smaller loans. He noted that bank credit to the economy was increasing. Although he worried about growing dependence of the GOE debt market on capital inflows, he was also clearly delighted to show the Ambassador a Citibank report showing Egypt as having the world's highest foreign-exchange reserves relative short term external debt and noted that the high level of reserves should contribute to a possible investor upgrade soon (Citibank projects an upgrade later in 2007).

14. (U) The Governor went on to tout the CBE's institutional strengthening, which he said USAID's project grants had supported very substantially. (COMMENT: The Governor may have been lobbying for approval of his large pending request for additional USAID project funding, much of which is proposed for salaries. END COMMENT.) In response to the Ambassador's question, he assured us that he was establishing management systems which should sustain the high-quality personnel that USAID's assistance had allowed the CBE to recruit. The Governor also announced that he was negotiating a two-to-three year extension in EU assistance for the CBE's banking supervision function, an area that the USG could potentially be interested in assisting in, particularly given the link to bank performance in the cash transfer program. The Governor also hinted that he would prefer to retire at the end of his term later this year, but that President Mubarak wanted him to stay. The Governor did not mention the GOE's decision to privatize the Banque du Caire, which was publicly announced two days after the Ambassador's meeting.

Governor pledges fast action on audits

15. (U) When the Ambassador shifted the conversation to the key question of the cash transfer and the need for mutually agreed TORs for the state-owned bank audits, the Governor assured us that he could move very rapidly to get audit firms to work and generate the data needed once the USG approved his TORs, citing an extremely optimistic 30-day implementation goal. (NOTE: Participants learned later that the CBE had sent TORs to USAID/Egypt's offices just before the meeting with the Ambassador. END NOTE.) The Treasury attache noted that the TORs would need careful review, and the Governor indicated he was open to any language suggestions from the USG, as long as a new "audit" of the banks was not requested. The Ambassador agreed to review the TORs and respond to the Governor

quickly so that the international firms could begin their work.

New TORs are accepted

16. (U) Immediately following the meeting with the Governor, Embassy coordinated with Washington agencies to provide comments on the TORs. The goal of the suggestions was to ensure that the firms would cover the audits with certification letters with more specificity about adherence to international standards. We presented compromise text to the CBE on July 26 and on August 16 the CBE accepted the language and indicated that the international audit firms would commence work immediately.

Comment

17. (SBU) This process has brought to a close a worrisome, open-ended period of delay in the CBE's implementation of actions essential to implementation of the Financial Sector cash transfer. (As soon as the new audit information is complete, it will be reviewed against the 2005 baseline audits to determine what amount should be disbursed.) We can only speculate on the reasons for the CBE's long delay, aside from the absence of any sense of urgency on the balance of payments side. We discount the Governor's implication that he was waiting for USG guidance on desired changes in the TORs; the ball was clearly in the CBE's court. However, given that the privatization plans for the Banque du Caire were announced shortly after the meeting with the Ambassador, it seems likely that action on the state-owned bank audits was caught up in internal GOE debates over bigger issues in the GOE's financial-sector reform program. Interestingly, CBE staff have separately informed us that other CBE actions were in fact sidetracked for this reason. The GOE insisted at the time of negotiating the cash transfer that it had its own long-term financial reform program, but that it could not, at least at that time, commit to more specific privatization actions. The Banque du Caire announcement lends that claim increased credibility, which is good news.

